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TAX FOUNDATION'S **50th Anniversary Year** VOL. 31, NO. 4 MAY/JUNE 1987

TAX·FEATURES

Cost of Congress Tops $2 Billion, As Legislators Raise Their Pay 16%

The U.S. Congress gave itself a 16 percent pay raise in March. Members' salaries jumped from $77,400 to $89,500, and a half-dozen congressional leaders will get even more.

Consequently, it comes as no surprise to Tax Foundation economists that, overall, spending on the Legislative Branch will rise by 28 percent in fiscal 1987. That's the estimated increase — $467 million — contained in the budget the President submitted in January. Total 1987 costs are put at $2.1 billion, up from less than $1.7 billion in fiscal year 1986.

At a 28 percent growth rate for fiscal 1987, the cost of Congress is sharply outpacing the overall trend of 3 percent for Federal spending this year. Congress will cost taxpayers twice as much as it did ten years ago and more than eight times 1967 levels.

In 1977, the Tax Foundation published a study warning that Congress was becoming "The Next Billion Dollar Bureaucracy." Within two years that prediction had become fact, when Federal outlays broke the $1 billion barrier in 1978. At current rates of increase, Congress as a "$3 Billion Bureaucracy" is just around the corner.

The 1988 budget includes a supplemental request for nearly $34 million in 1987 appropriations for increased pay costs for the Legislative Branch and over $54 million for increased costs of retirement contributions on behalf of Members of Congress and their staffs.

(Continued on page 2)

TF's Shadow Budget Committee Calls on President and Congress To Work Together to Cut Deficit

Cooperation, realism, and a deficit reduction mechanism with teeth are needed "to bring significant, real deficit reduction," Tax Foundation's Shadow Committee on the Federal Budget maintained in its May 8th report. Charging that the recent turbulence in financial markets adds urgency for progress, the report stated, "a lower deficit would ease dependence on foreign lenders, slow the rise in interest payments, facilitate accommodations with trading partners, and contribute to overall economic stability."

The Committee detailed three elements that must coalesce if progress toward bringing down the deficit is to be real and lasting:

- "The President and Congress should work to reconcile their divergent budget policies and endorse concrete actions that would turn their promises of lower deficits into reality."
- "The President and Congress should adopt realistic deficit targets for the 1988 fiscal year based on credible economic forecasts and program assumptions."
- "The G-R-H and congressional budget process should be strengthened to ensure more effective enforcement of budget decisions, deficit levels, and budget priorities."

"Pressure for budget negotiations may escalate in the coming weeks as Congress faces the need to raise the debt limit and as fresh efforts are made to revitalize the G-R-H process," the report concluded. "As part of an agreement on the budget, Congress and the President should devise strengthened procedures for meeting the deficit targets. Just setting new targets without effective enforcement will not enhance fiscal responsibility."

Members of the Shadow Budget Committee are The Honorable Harry F. Byrd, Jr., W. Bowman Cutter, Paul H. O'Neill, Rudolph G. Penner, and Allen Schick. The report, "Reducing the Deficit when Growth Slackens," is available from the Tax Foundation for $4, plus $1 for postage and handling.

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Outlays for the Legislative Branch of the Federal Government by Unit
Selected Fiscal Years 1966—1987(a)
(Thousands)

Unit	1966	1976	1986	1987
Total	$231,505	$775,366	$1,664,516	$2,131,457
Congress, total	111,865	374,122	849,931	1,020,476
Senate	35,388	123,851	273,223	331,713
House of Representatives	68,095	197,525	470,741	574,722
Joint activities	8,382	52,746	105,970	114,041
Legislative agencies, total	119,640	401,244	814,582	1,110,981
Architect of the Capitol	26,158	57,281	94,696	188,893
Botanic Garden	497	1,235	2,107	2,267
Congressional Budget Office	—	2,763	15,678	17,853
General Accounting Office	46,136	131,778	288,533	307,546
Government Printing Office	21,662	93,391	56,423	114,676
Library of Congress	25,187	117,193	334,335	442,668
Office of Technology Assessment	—	5,035	14,309	16,474
U.S. Tax Court	—	6,919	22,147	26,387
Other	—	1,447	1,984	3,082
Deductions for offsetting receipts	—	-15,798	-15,630	-8,865

(a) Data for 1987 are estimates from the Budget presented in February 1987
Source: Office of Management and Budget

One Trillion Dollars of Federal Loans But No Such Thing As Free Credit

The Federal government operates huge credit programs that cost taxpayers billions of dollars. Each year, the government makes or guarantees approximately $200 billion of new loans to farmers, homeowners, businesses, students, and many other borrowers. Right now, about $250 billion in direct loans and $450 billion in guaranteed loans are outstanding; an additional $450 billion has been lent by government-sponsored enterprises such as the Farm Credit System.

Costless Assistance?

One reason why credit assistance is popular is that beneficiaries often claim (and governments sometimes pretend) that it is costless. Credit programs are not costless. They have two basic features of regular expenditures: a cost to the government and a benefit to recipients. The cost and benefit depend on the terms of the assistance and on the financial condition of the borrower. A loan provided at an interest rate below the government's own borrowing costs will be more expensive to taxpayers than one provided at the same rate; a guarantee that eventuates in default will cost more in public outlays than one which does not lead to government payment.

Direct loans

The Federal government issues more than $40 billion in direct loans each year. Unlike businesses, which count loans as assets, the Federal government budgets these loans as outlays. Thus, total budget outlays include new loans minus the repayment of old loans.

In recent years, Congress has installed a credit budget in an effort to control the amount of direct loans obligated each year. The credit budget process consists of two parts: (1) Each budget resolution adopted by Congress sets forth a total amount that may be obligated in direct loans during the fiscal year and allocates it among the various functions in the budget. (2) The amount of loans that may be obligated for particular programs is limited in appropriation bills. However, these limitations have not been effective in controlling credit programs where eligible persons have a legal right to borrow from the Treasury.

Direct loans usually provide a number of subsidies to borrowers, the largest of which usually derive from charging interest rates below market levels. Direct loans are also subsidized by deferring interest payments, waiving loan fees, allowing grace periods to borrowers who do not repay on time, and lending funds to high-risk borrowers who could not get commercial loans.

Although it is difficult to compute the subsidy value of these loans, the Office of Management and Budget (OMB) has estimated that they add up to about $8 billion a year. OMB has proposed a credit reform that would make the subsidy value of these loans explicit. The government would discontinue the practice of recording the face value of new loans as an outlay in the budget; instead, it would resell these loans to

(Continued on page 3)

General Sales Biggest Tax Source for States

Sales taxes still bring in the most money for the states, according to recent analysis by the Tax Foundation. Economists at the Washington-based tax watchdog organization say that general sales taxes, which are levied by 45 states, brought in $74.8 billion to state treasuries in fiscal year 1986 — nearly one-third (32.8 percent) of all state tax collections for that year.

Second as a major revenue raiser was the personal income tax, bringing in $67.5 billion in fiscal 1986 for 29.6 percent of total tax receipts. Corporate income taxes, the third largest single tax source, amounted to $18.4 billion, 8.1 percent of the total. Only five states (Nevada, South Dakota, Texas, Washington, and Wyoming) have neither a corporate nor a personal income tax, and only seven states (the previous five plus Alaska and Florida) have no individual income tax.

All 50 states tax gasoline and motor fuels, which brought in $14.1 billion (6.2 percent) of total taxes in fiscal 1986.

All states have local property taxes, and 41 have state property taxes; 39 states have both general sales and income taxes; and 33 states have general sales, income, and property taxes, Tax Foundation economists say.

State Sales Taxes

Connecticut led the list for top rates with its 7.5 percent sales and use tax rate, followed by: Washington ,6.5 percent); Minnesota, Mississippi, New Jersey, Pennsylvania and Rhode Island (6 percent); and Nevada (5.75 percent).

(Continued on page 4)

(COST OF CONGRESS, *from page 1)*

The pay and benefits increase was recommended by the President and automatically takes effect, absent action by Congress. In 1985, Congress turned over to the Chief Executive the power to set congressional salaries unless two-thirds of both houses reject his recommendation within 30 days. The Senate voted overwhelmingly in January to block the pay hike, but the House waited until a day after the legally mandated deadline before voting to refuse the proposed salary increase, so the raise automatically went into effect.

The bill for running the Congress itself (Senate and House) will exceed $1 billion in 1987, 20 percent more than last year. The Senate will cost taxpayers $332 million ($3.3 million per Senator), while the House will require $547 million ($1.3 million per U. S. Representative).

Congress also maintains a number of legislative agencies that will spend a total of $1.1 billion in 1987, 36 percent higher than last year. Two of these agencies — the Architect of the Capitol and the Government Printing Office — will double their budgets; and the budgets of nearly all other legislative agencies also show substantial increases.

Congress has been patting itself on the back for holding mail costs at last year's $95 million level. There will be considerably less chortling next year — an election year — when official mailings are expected to cost $134 million, more than 40% above 1987 allowances.

Will Rogers once said the American taxpayer should be grateful they're not getting all the government they're paying for. He didn't say, however, they should be grateful to be paying so much for the kind of government they were getting.

Tax Features

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FEDERAL TAX POLICY MEMO

Editor: Edward A. Sprague, Senior Vice President—Program Planning and Tax Policy

MAY/JUNE 1987

More Battles Over Tax Burdens

Summary

- Because of the deficit and other factors, there will be a continual testing of sentiment to retain or raise top marginal tax rates.
- The historical record does not support charges that the Federal tax system has become much less progressive and rewards the rich.
- The specific way the Tax Reform Act of 1986 (TRA-86) was crafted leaves an opening for top rate hikes, but, if rates are raised, they will have to reach down to at least the upper-middle income groups to realize significant revenues.
- Fiscal policy restraint and value-added taxation are viable alternatives to income tax increases.

Speaker Jim Wright (D-TX) is not likely to succeed in his proposal to extend the top personal tax rates of 1987 as a means of reducing the budget deficit. The commitment to the tax rate schedule under the Tax Reform Act of 1986 appears strong enough to allow the reduction from a top of 38-1/2 percent this year to basically 28 percent in 1988 to take place. That will not be the end of it, however. A good number of tax policy observers believe that the 28 percent rate is politically unstable. There will be continued testing of sentiment to reimpose higher personal rates in the future.

Obviously, the persistent, big budget deficit and the perceived need to grind away at it will keep all sorts of tax initiatives on the front burner in consideration of budgets for fiscal 1988, 1989, and 1990, anyway. In fiscal 1988, a combination of avowed spending restraint, government asset sales, increased fees, and selected new excises may get us through the year, perhaps in paper compliance with a less restrictive Gramm-Rudman-Hollings deficit reduction target. This would allow putting off more drastic action for another year.

We should never underestimate the resourcefulness of government to resort to new gimmickry. But the 1988 election should sharpen the focus again on national priorities and the way to finance them. And, despite the strong opposition of the current Administration, it's not too difficult to construct a scenario for higher, and more progressive, income taxes. It goes like this:

On the Spending Side

- There is "no constituency" for restraining the growth of entitlements, especially Social Security; and defense spending increments cannot be cut back further without serious risk to national security.
- Non-defense, non-entitlement spending cannot be cut back significantly any more. In fact, there are building pressures to expand a number of Federal programs, such as aid to the homeless and state/local infrastructure improvements. (Witness the override of the President's veto on the highway bill.)
- A major new Federal program in health care could be very costly, even if means tested.
- Bailouts of the farm credit and thrift system also could be very expensive.

On the Tax Side

- The impact of TRA-86 is far from revenue neutral. Receipts lag well behind projections—although the specific blame for this undoubtedly could not be proven and apportioned, even after the fact.
- Continued economic growth—discounting a recession—produces revenue gains, but they are constrained by indexing of the personal tax structure.
- Post-TRA-86, there are still opportunities for base broadening in the income tax, but they are extremely difficult to implement. Furthermore, while big business bashing may be in vogue during the 1988 election, there is a realization that business "gave at the office" in TRA-86 and that further significant increases in corporate income taxes will jeopardize the economy.
- There is not enough political steam behind a value-added, or new broad-based, consumption tax.

What's left on the shelf? Jim Wright's approach is certainly up there. Freezing the top personal rate at 38-1/2 percent is alleged to net revenue gains of at least $30 billion over three years, a nice start on the budget problem (on paper, anyway), according to its supporters.

There is another factor here that doesn't relate directly to the budget. There has been a spate of new studies on income and wealth distribution in the U.S. Most of them portray an increase in income inequality since the early post-war years. Census figures do show a slight increase in the percentage of household income received by the top fifth from 1959 to

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Table 1

Household Income

Year	Percent of Total Income Received: Lowest Fifth	Top Fifth
1947	5.0	43.0
1959	4.9	41.1
1969	5.6	40.6
1979	5.2	41.7
1985	4.7	43.0

Source: Census Bureau, U.S. Department of Commerce

1985 and an even slighter drop in the amount received by the bottom fifth (see Table 1).

Interpretation of this type of data is in considerable dispute. There appears to be only very modest evidence that "the rich are getting richer and the poor, poorer." Yet, that is a widespread perception in media reports and seems to be taking hold in the legislative arena, as well. It is reinforced by continuing attacks on the 1981 tax cuts as "welfare for the rich."

A Brief History

It's true that the landmark 1981 tax bill (ERTA) did reduce the dollar tax burdens of upper-income taxpayers substantially, and because the principal thrust of it was an across-the-board proportional cut in rates, there was not much impact at the low end of the income scale. But ERTA should not be considered in isolation. It followed a series of post-war tax adjustments that gave relief mainly to the low and low-middle income groups. The 1978 act was an exception, but the main legislative thrust, particularly during the 1969-1977 period, was to redistribute income downward.

More important for actual results, as detailed in previous *Federal Tax Policy Memos*, was the interplay of inflation and graduated tax rates pushing people up the bracket ladder without necessarily accompanying increases in ability to pay. The net result was a markedly progressive individual tax structure pre-1981, which was eroded only slightly by ERTA. To quote tax analyst Joseph Minarik of the Urban Institute, ". . . People who dislike the effect of the 1981 tax cuts must recognize that the law it replaced was a post-1954 extreme, more progressive in its distribution of the tax burden . . . than any law of the preceding 25 years, reached as much through drift as conscious choice. Without the marginal rates over 50 percent, which were removed with general approval, no substitute for the 1981 tax cuts could perpetuate the progressivity of the 1981 tax law."

TRA-86 was more concerned with "horizontal" equity—equalizing tax burdens within income tax classes—than with the overall distribution. By raising exemptions and the standard deduction, it does reduce the share paid by the lowest income groups, and is estimated to knock some four million families off the rolls entirely in 1988 alone. (Some of these are the same ones taken off the rolls by earlier actions, then recaptured through inflation.) Other than at the bottom, effective rates of tax among income groups changed only marginally, according to the Joint Committee on Taxation analysis shown below in Table 2. The structure was progressive before TRA-86 and a bit more progressive afterwards, despite the elimination of numerous graduated rates. It also can be argued that, because these taxes ultimately are borne more by owners of capital than by others, the Joint Committee distribution analysis understates the increase in progression under TRA-86.

In terms of actual liabilities, upper-income taxpayers as a group consistently have carried a very large burden, and, since ERTA in 1981, this burden has grown, despite the rate cuts. The Tax Foundation has provided an annual analysis of the share of Federal income taxes paid by adjusted gross income class. In 1984, the last year of record at this writing, the highest 5 percent of returns, with incomes of $59,500 or more and an average tax liability of $23,300, paid 38.2 percent of the total individual income tax—compared to a $17,400 average tax payment and 37.6 percent share in 1979. Increases in tax liabilities of income groups over $100,000 were particularly sharp, despite the cut in top marginal rates from 70 percent to 50 percent.

Table 2

Average Income Tax Rate Under Prior Law And the Tax Reform Act of 1986 By Income Class, 1988

Income Class (in thousands)	Average Income Tax Rate (percent): Prior Law	TRA '86
$ 0 - 10	1.6	0.5
10 - 20	5.7	4.4
20 - 30	8.3	7.5
30 - 40	9.5	8.7
40 - 50	11.1	10.1
50 - 75	13.3	13.1
75 - 100	15.7	15.6
100 - 200	19.3	18.9
200 and above	22.8	22.3
Total	11.8	11.1

Source: Joint Committee on Taxation

What about payroll taxes and state/local taxes? It's charged that these are mostly regressive, and the overall system is, therefore, much less progressive. That may be statistically true, but it is of uncertain implication for Federal tax policy. "Regressive" Social Security taxes support a "progressive" benefit structure for retirees. Under our Federal system, states and localities are free to design their own tax structures, and the distributional effects of these taxes are not subject to challenge at the Federal level.

It's interesting to note that, even with the growing burden of Social Security taxes combined with Federal income taxes, the Federal system remains progressive. Joseph Minarik's analysis of families subject to different tax laws over the last thirty years is shown in Table 3 below. (The analysis concerns one-earner families, and, admittedly, with two-earner families it probably would show a less progressive comparison.)

Whatever the reasons for any increase in income inequality in the U.S., Federal tax policy appears to have had little to do with it. If anything, policy has leaned in the other direction. This hardly means that tax policy is irrelevant to future social policy choices, but it does put it in a different perspective than many media reports.

Rate Hike Agenda

What if we do embark on a program to exact more dollars from upper-income taxpayers? In the first place, to make any real difference in dollar terms, such a program also would have to hit the near-rich and probably those who only aspire to that status—in other words, getting down towards the middle class.

In the past, the Tax Foundation put out a regular report on how long we could run the government if it *confiscated* all income taxed at marginal rates higher than 50 percent. In 1980, it was eight days, based on a net to the Treasury of $13 billion resulting from total confiscation of that income on 1.8 million returns, 2 percent of the returns filed. This particular exercise, of course, is no longer pertinent with the top rates down to 50 percent after 1981 and headed lower. But the point is still valid. There simply aren't enough of them to make a "soak-the-rich" campaign viable, as much as it might please dedicated income redistributors.

Of course, after TRA-86, theoretically we could raise significant money by jiggling the top rates well short of confiscation. But this would affect millions of middle-income people. This year's 35 percent rate cuts in at $45,000 of taxable income for joint returns and $27,000 for single returns. That's why the commitment to the 1988 rate structure may be viewed as pretty strong among taxpayers well shy of fat-cat status.

Still, the specific way the reform legislation was crafted does leave an opening. In order to arrive at the designated distribution table and also to save revenue, Congress decided to phase out the benefit of both the 15 percent rate and the personal exemption, beginning in 1988. These decisions, in effect, created a third marginal rate of 33 percent applying to taxable income in excess of $71,900 for joint returns and $43,150 for single returns. The reach of the surcharge depends on the number of dependents claimed. A three-dependent, joint-return family would pay the 33 percent surcharge rate on income between $71,900 and $182,500 and a flat rate of 28 percent on any income above that.

These income notches cause confusion and some planning difficulties for a lot of upper-income taxpayers. They also give the critics a free shot at the idea of the truly rich paying a lower rate than the near-rich. A cleaner way to have handled it would have been to change the personal exemption into a flat percentage credit applied across the board along with the intermediate tax rate. This may not have yielded the same precise distribution table, but it would have done away with the notches. As it is, the structure invites a move to extend the 33 percent temporary rate to all income above the breakpoints.

Marginal Rates and Incentives

Behind the move to cut top marginal rates have been two policy objectives: to increase work and savings incentives and to improve the equity of the structure by discouraging tax shelter arrangements. The former has been stressed mainly by supply-siders; the latter, by tax reformers. When they came together, they exerted a powerful push on policy, as in early 1981, when the Democratic majority of the Ways and Means Committee jumped the gun on cutting the marginal rate from 70 percent to 50 percent in one swoop, when the Reagan Administration had proposed a more cautious, three-step phase-in of top rate reduction.

As indicated, tax receipts from the groups most affected by the marginal rate cuts have risen substantially. There's debate, however, over how much can be attributed to the tax

Table 3

Federal Tax Rates on Families at Multiples of the Median Income Income and Social Security Taxes Selected Years, 1954—1984

Federal Tax Law	Multiples of the Median Income						
	0.25	0.5	1	2	3	5	10
1954	2.00	2.00	7.82	12.87	15.37	18.96	28.37
1965	3.63	6.17	10.24	13.17	16.16	20.88	31.12
1975	-4.35	8.32	15.22	17.44	21.03	27.44	36.13
1980	-2.51	11.53	17.97	21.65	26.42	32.51	40.90
1984	2.03	13.03	17.29	20.62	23.61	27.90	34.22

Source: Joseph J. Minarik, Making Tax Choices (Washington, D.C.: The Urban Institute Press, 1985), p. 45. Copyright 1985 by the Urban Institute.

incentive effect on work effort, to increases in capital mobility and realizations because of the lower capital gains taxes, or simply to better overall economic performance after the 1981-82 recession. One thing the 1981 bill did not do was to discourage investment in tax shelters. Instead, these tended to blossom right through 1985.

It can be argued that the cut to a 50 percent top tax rate in 1981 was not a true test of the supply-siders' or reformists' objectives, in part because earned income was taxed at that rate previously. Now, with the prospect of a basic 28 percent rate, the outlook should be more promising. In fact, there is evidence that the combination of the lower tax rates and the crackdown on shelters has turned attention much more to economic income-producing, rather than tax-motivated, investments. This trend should continue.

The effect on savings is more problematic. The current personal savings rate is abysmally low. TRA-86 did away with some specific savings incentives, and, despite the drop in rates, its overall tilt, for the intermediate term anyway, is pro-consumption. Nevertheless, it can be argued with more authority that any *increase* in top rates on top of the base broadening under TRA-86 would have distinctly negative effects on personal savings and capital formation. So much so, in fact, that any serious move to impose higher marginal rates could rejuvenate interest in exempting savings, such as through the super-IRA proposal of Senator William V. Roth (R-DE), and to bringing back a partial exclusion of capital gains.

Ability to Pay

The "ability-to-pay" principle is deeply embedded in our system. There's not much argument whether it should apply. But the case for graduated and progressive rates to implement that principle has been an uneasy one. Supply-siders argue that high rates are simply counterproductive. Many tax reformers are troubled by the implications of high marginal rates as an invitation to special treatment, complexity, and non-compliance. And there was always the problem of arbitrary brackets and rates set not in relation to some grand plan for income redistribution but as after-effects of past events. Rates as high as 91 percent during the Korean War persisted for thirteen years afterwards. There was plenty of interest in reducing them but no agreement on how to rework the schedule until 1964.

One of the appeals of the flat tax movement is that it would render moot many of the questions about progression. A flat low percentage on a broad base is inherently attractive on that score. Unfortunately, it couldn't be designed without transferring a large tax burden from the top income groups to the middle. Thus, we have the compromise in TRA-86 to liberalize low-income allowances and set two basic rates with the phase-outs of the first rate and the personal exemption. This somewhat imperfect compromise did preserve the "ability-to-pay" principle and progression of the structure without the overlay of twelve additional rates that applied in 1986.

If the new structure can be retained over time, it might well be a confidence building factor for all taxpayers. If they think the decision of the taxwriters as to basic rates will hold, they might well be less concerned with lost exclusions and deductions, less anxious to carve out new ones, and more willing to self-assess their liabilities in a forthright manner.

Other Scenarios

The looser spending control/tax increase scenario sketched earlier doesn't have to be. The proposition that we can grow out of the budget deficit is maligned these days, but it could just happen with some policy help. Mainly because of pullbacks in defense authorizations, the structural deficit outlook has brightened over the last year and a half. A serious effort to restrain the growth of entitlement outlays—which probably couldn't occur until after the 1988 elections—might offset the buildup of spending pressures elsewhere. If the next recession is very mild, tax receipts could stay in a rising trend despite all the changes under TRA-86.

What if we are not so lucky, and the deficits continue apace with the feared economic consequences? There are still alternatives to increasing income taxes. At the top of the list is a value-added tax. Most observers now agree that *if we are going to have* a broad-based consumption tax at the Federal level, the most acceptable form is value added. This would accommodate trade policy and minimize problems with the states. It is not necessarily "regressive" in impact. At the same time, it could gather big bucks, and this scares those concerned with limits on government. There isn't any good answer to this concern, except, of course, that the alternatives could be worse.

At present, there is no consensus on the need for a consumption tax. And one could not develop without some careful nurturing. A premature legislative thrust, such as occurred in 1978, could turn the body politic more firmly against it. Still, the coming elections could provide a forum for such development—probably not as a specific referendum on a consumption tax itself, but as a testing of the national will to control fiscal policy and maintain a lower profile of individual income tax rates.

(CREDIT, *from page 2*)

private investors, then charge the difference between the amount of the loans and the revenue from reselling them as a subsidy.

Sale of Loan Portfolio

The Administration and Congress have also embarked on a plan to sell old loans as a means of reducing the budget deficit. The government plans to sell about $8 billion of loan assets in the 1987 fiscal year and $11 billion in the 1988 fiscal year. Since it is holding $250 billion in direct loans, the government could continue selling these loan assets for many years to come.

However, the sale of loans does not generate dollar-for-dollar deficit reduction. Inasmuch as most direct loans are subsidized, their market value is below their face value.

The Congressional Budget Office (CBO) has estimated that the $11 billion of loan assets proposed for sale in fiscal 1988 would bring in slightly more than $5 billion — less than 50 cents on the dollar.

Using Loans to Reduce Deficit

The use of loan assets to reduce the reported deficit is controversial. For one thing, the impact on financial markets is similar to additional government borrowing; for another, the sale of these assets can worsen future deficits, because the government foregoes the future interest and principal repayment of the loan assets it sells. CBO has suggested that loan asset sales be treated as means of financing the deficit, not counted as revenues.

Loan guarantees

The Federal government guarantees upwards of $150 billion in loans each year, far more than it directly lends. In fact, the volume of guaranteed loans has soared in recent years while the amount of direct loans has declined. Unlike direct loans which, under current accounting practices, generate outlays and add to the deficit, guaranteed loans produce outlays only in case of default.

The growth in guarantees is partly due to financial pressures. When the budget is tight, the government has an incentive to provide assistance by means of guarantees which do not immediately raise outlays or the deficit. Nevertheless, loan guarantees have subsidy effects and influence capital markets. They allocate credit, favor some borrowers over others, and shift the risk from private lenders to taxpayers. OMB has estimated that loans guaranteed by the Federal government in fiscal 1986 had subsidies valued in excess of $10 billion. With government experiencing default rates as high as 20 percent in ship financing programs and an estimated 10 percent in certain guaranteed farm loans, more than $8 billion in guarantees were terminated for default in fiscal 1986.

When default occurs, the government has no effective control over the ensuing outlays. OMB has proposed to show the present value of the subsidy by purchasing commercial insurance for loans guaranteed by the government. The cost of the insurance would represent the value of the subsidy. In the short run, this insurance would add modestly to the budget deficit; but, presumably, it would lower long-term deficits by shifting the risk back to private insurers.

• • •

Direct and guaranteed loans are a legitimate means of providing assistance and they can be an efficient substitute for direct expenditures. But as long as their true cost is concealed in the budget, borrowers may be getting a free lunch for which the taxpayers have to pick up the bill.

THE FRONT BURNER

By Robert C. Brown, President
Tax Foundation

"Sobering Thoughts"

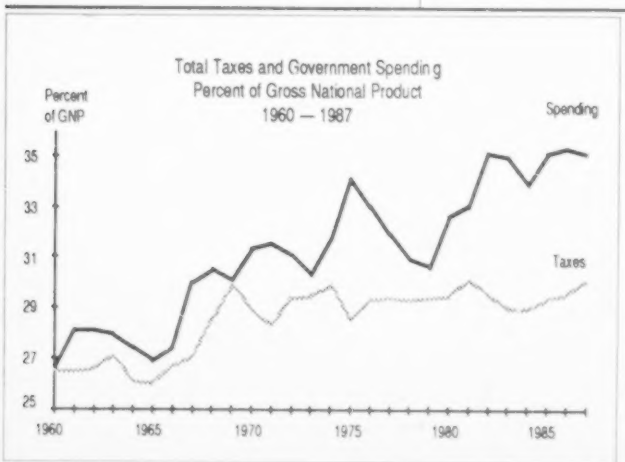
Cooperation, honesty, and courage. These are the traits the Tax Foundation's Shadow Committee on the Federal Budget recommends to Congress and the Administration as the deficit reduction debate goes forward. The very need to publicly affirm such basic staples of social intercourse gives food for thought.

Admittedly, neither the White House nor the Capitol are monasteries. Admittedly, Washington has no lock on shady dealings this season. Still, it is disheartening to contemplate a government whose ethical clutch seems to have slipped badly.

However, the Shadow Committee's recommendations are not mere moral posing or an attempt to assume some kind of "holier-than-thou" stance. They are a call to reaffirm once again the principles that have enabled this nation to work so well for more than two centuries: "We must all hang together, or we will most assuredly hang separately." "Honesty is the best policy." "Vote your conscience."

If the American people ever lose faith in their public institutions, it will be because they have concluded that the men and women who have been given the privilege to make those institutions work have betrayed their trust. The mockery that has become the annual budget process is inching dangerously close to that perception.

That's a sobering thought in this, the 200th year of our Constitution.



"Wall Street Week" Features TF Data

On Friday, May 15th, the popular PBS television program, "Wall Street Week," made extensive use of Tax Foundation analyses of taxing and spending by all government. Host Louis Rukeyser used video charts similar to the graph at left to show that in 1987 total taxes have reached the 1981 peak level—over 30 percent of GNP—and that the Federal tax cuts under that year's Economic Recovery Tax Act (ERTA) had produced only a fleeting decline in total tax burdens.

Rukeyser also noted the continued rise in government spending as a percent of the overall economy, up two full percentage points since 1981. Total government spending will exceed 35 percent of GNP in 1987; this spending trend has clearly been the driving force to enlarge the government's share of the economy and the deficit as well.

(SALES TAX, *from page 2*)

No state general sales tax is levied in Alaska, Delaware, Montana, New Hampshire, or Oregon, although municipalities in Alaska do impose sales tax.

The state sales tax is lowest — 3 percent — in four states: Colorado, Georgia, North Carolina, and Wyoming. Localities in 29 states levy sales taxes, generally in addition to those shown in the accompanying table.

Individual Rates

Iowa (13 percent) and Connecticut and North Dakota (12 percent) have the highest marginal individual income tax rates. The rate schedules are progressive (i.e., rise as income brackets go up) in all but five states. Illinois, Indiana, Massachusetts, Michigan, and Pennsylvania apply a flat rate, regardless of income level. In two states, income taxes are levied as a percentage of Federal individual income tax obligations — Rhode Island, and Vermont.

The maximum corporate income tax rates are highest in Iowa (12 percent); Connecticut (11.5 percent); Arizona and North Dakota (10.5 percent); and New York (10 percent).

Gasoline Tax

Gasoline taxes are highest in Montana (20 cents a gallon), Nebraska and Utah (19 cents) and Hawaii (where combined state-local rates range from 16 to 19 cents a gallon). The lowest rate — 4 cents — is levied in Florida, where gasoline is also subject to the general sales tax. The next lowest — 8 cents — applies in Alaska, New Jersey, New York, and Wyoming.

Cigarette Tax

Cigarette taxes also make a notable contribution to state tax revenues, Tax Foundation economists report. In fiscal 1986, the states collected $4.4 billion, 2 percent of their total taxes, from tobacco products excises. Rates range from a high of 38 cents a pack in Minnesota to 2 cents in North Carolina.

The adjacent table gives further details, as of July 1, 1987, for major taxes and rates prevailing in the states.

Publications Available from TF

"Memorandum on the Allocation of the Federal Tax Burden and Federal Grants-in-Aid by State, Fiscal Year 1986" (July 1987) $4.00.

"Federal Tax Burdens in State and Metropolitan Areas" (1974). Describes methods used to derive above allocation formula. $1.50.

Reports from the Shadow Committee on the Federal Budget: ($2.00 for members, $4.00 for non-members):
"Reducing the Deficit When Growth Slackens" (May 1987)
"More Than Wishful Thinking Necessary to Reduce the Deficit" (February 1987)
"The Misuse of Continuing Resolutions" (October 1986)

"A Capital Budget for the Federal Government?" (Working Paper – November 1986) $2.00 for members; $4.00 for non-members.

Please add $1.00 for postage and handling.

Major Taxes and Rates Used by States, July 1, 1987

As Reported through June 2, 1987

State	Income Taxes: Corporation	Income Taxes: Individual	General Sales and Use Tax	Gasoline Tax (per gallon)	Cigarette Tax (per pack of 20)	Property Tax
AL	5%(F)	2 to 5%(F)	4%(a)	11 cents	16.5 cents	X
AZ	2.5 to 10.5(F)	2 to 8(F)	5(a)	16	15	X
AR	1 to 6	1 to 7	4(a)	13.5	21	X
CA	9.6	1 to 11	4.75(a)	9	10	X
CO	5 to 5.5	3 to 8(F)	3(a)	18(b)	20	X
CT	11.5(c)	1 to 12(d)	7.5	17(e)	26	X
GA	6	1 to 6	3(a)	7.5 + 3% of retail	12	X
HI	5.85 to 6.435	2.25 to 11	4	16 to 19	40% wholesale	
ID	8	2 to 8.2	5	14.5	18	X
IL	4	2.5	5(a)	13	20	X
IN	3.4(f)	3.4	5	14	15.5	X
IA	6 to 12(F)	.5 to 13(F)	4(a)	16	26	
KS	4.5(g)	2 to 9(F)	4(a)	11	24	X
KY	3 to 7.25	2 to 6(F,n)	5(a)	15(i)	3.001	X
LA	4 to 8(F)	2 to 6(F)	4(a)	16	16	
ME	3.5 to 8.93	1 to 10	5	14	28	X
MD	7	2 to 5	5	18.5(i)	13	X
MA	8.33(j)	5(k)	5	11	26	X
MI	2.35	4.6	4	15	21	X
MN	9.5	4 to 9(p)	6(a)	17	38	X
MS	3 to 5	3 to 5	6	15(e)	18	X
MO	5(F)	1.5 to 6(F)	4.225(a,b)	11	13	X
NE	4.75 to 6.65	2 to 5.9	4(a)	19	27	X
NJ	9(l)	2 to 3.5	6	8	25	X
NM	4.8 to 7.6	1.8 to 8.5(m)	4.75(a)	14	15	X
NY	10(c)	2 to 8.75(b)	4(a)	8	21	
NC	6	3 to 7	3(a)	15.5	2	X
ND	3 to 10.5(F)	2.67 to 12(F,n,o)	5.5(b)	17	27	X
OH	5.1 to 9.2(c)	.751 to 6.9(b)	5(a)	12	14	X
OK	5	.5 to 6(F,m)	4(a)	16	23	
PA	8.5	2.1	6	12	18	X
RI	8(c)	23.96% of Federal income tax	6	13(i)	25	X
SC	6	2 to 7	5	13	7	X
TN	6	6(d)	5.5(a)	17	13	
UT	5	2.25 to 7.75(F)	5.094(a,b)	19	23	X
VT	6 to 9(b)	25.8% of Federal income tax	4(b)	13	17	X
VA	6	2 to 5.75	3.5(a)	17.5	2.5	X
WV	9.75(b)	3 to 6.5	5	10.5	17	X
WI	7.9	5 to 7.9	5(a)	18	25	X
FL	5.5	These 7 states have no individual income tax	5(a)	4	24	X
NV	These 5 states have no corporate income tax		5.75(a)	11.25	15	X
SD			5(a,b)	13	23	
TX			5.25(a,b)	15(b)	20.5	
WA			6.5(a)	18	31	X
WY			3(a)	8	8	X
AK	1 to 9.4	These 5 states have no general sales tax		8	16	X
DE	8.7	1 to 8.8(F,h)		13	14	
MT	6.75(e,m)	2 to 11(F)		20	16	X
NH	8	5(d)		14	17	X
OR	6.6	5 to 9(F,h)		12	27	X

(X) Indicates state levies a property tax.
(F) Allows Federal income tax as a deduction.

(a) Local taxes are additional.
(b) Future reduction scheduled under current law.
(c) Alternative methods of calculation may be required.
(d) In Connecticut, New Hampshire, and Tennessee, tax applies to income from intangibles only, at various rates according to type. In Connecticut, capital gains are taxed at 7%.
(e) Future increases scheduled under current law.
(f) Tax is 3.4% of adjusted gross income. A supplemental net income tax is imposed at 4.5%.
(g) A 2-1/4% surtax is imposed on taxable income in excess of $25,000.
(h) Deductions limited.
(i) Tax imposed at percent of wholesale value.
(j) Additional 14% surtax is imposed.
(k) Tax of 10% on income derived from intangibles, and 5% on all other income.
(l) Additional tax on net worth is part of the corporate franchise tax.
(m) Qualified taxpayers may elect to pay alternative taxes at varying rates.
(n) Optional tax of 14% of taxpayer's adjusted Federal income tax liability.
(o) Additional 10% surtax is imposed for 1987.
(p) Plus 10% of Federal tax paid under Sec. 1(g) of Internal Revenue Code.

Source: Compiled by Tax Foundation from data reported by Commerce Clearing House.